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C O N F I D E N T I A L SECTION 01 OF 02 DUBLIN 000538

SIPDIS

TREASURY FOR VIMAL ATUKORALA

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TAGS: ECON PREL PGOV EFIN EI
SUBJECT: IRELAND: PREDICTABLE BUDGET/UNPREDICTABLE FINANCE MINISTER COMMENTS

DUBLIN 00000538 001.2 OF 002

Classified By: DCM Robert J. Faucher. Reasons 1.4(b/d).

¶1. (C) Summary: On December 9, the Irish government delivered its 2010 budget. Looking to save at least four billion Euro (USD 6 billion), the government had signaled for months that public sector pay and social welfare would make up a large chunk of the spending cuts and there were no great surprises. The 2010 budget is widely perceived as the most draconian in decades. It calls for USD 86.9 billion in spending and anticipates USD 54 billion in revenues, leaving a deficit of USD 32.9 billion. The only notable tax change was the expected imposition of a carbon tax. Finance Minister Brian Lenihan said that the economy has, "turned a corner," and that, "(this budget)is going to be the last of the very difficult budgets." The opposition attacked both Lenihan's comments and the government's social welfare cuts. Most commentators we have spoken to or who have commented publicly expect even more difficult budgets over the next several years. Lenihan's remarks will make next year's budget even more difficult to sell to the voter. End Summary.

Spending Cuts Predominate

¶2. (SBU) The Irish government "softened up" (as one of our contacts put it) the Irish public for the harsh budget by commissioning two independent bodies to recommend spending cuts and tax increases. The recommendations have been debated for months now so the announced spending cuts were no surprise. The key cuts amounted to around USD 6 billion (a little over two percent of GDP) and included reductions in public sector pay (USD 1.5 billion) and social welfare payments (USD 1.1 billion), with the remainder coming from capital spending cuts and other line-item current spending cuts. Public sector employees will face paycuts of five to 15 percent.

¶3. (C) As called for by private economists and the business community, the Irish government included very few tax increases. Rossa White, chief economist at Davy's Stockbrokers, told Econoff that the net tax increases totaled an almost negligible USD 25 million. The main tax change was the introduction of a carbon tax of USD 22.50/ton which will increase gasoline and heating fuel prices mainly. In an effort to revive the economy, the government is focusing on competitiveness -- both a reduction in the general price level and retaining and attracting globally mobile foreign direct investment. Raising marginal income tax rates or the now sacrosanct 12.5 percent corporate tax rate would have run counter to this push.

Minister Lenihan Creates a Target...

¶4. (C) In the past two days Finance Minister Lenihan has said that the economy has, "turned a corner," and that, "(this budget)is going to be the last of the very difficult budgets." Local economist Constantin Gurdgiev (and others we spoke to) told Econoff that both of these statements fly in the face of reality. By his calculations, the government will have to "find" at least an additional USD 21 billion over the next three budgets to come under the EU limit of a three percent of GDP deficit. He estimated that the structural deficit (that part of the deficit that will not disappear with an improved economy) is between five and eight percent of GDP. In a lunch last week with the Ambassador, Jim Power, chief economist at Friends First, said that he does not expect economic growth to return until at the earliest 2011. In a conversation with Econoff, Power echoed a point Gurdgiev made that the government's trend growth projection of 3.75 percent over the next several years is "wildly optimistic." If growth does not reach these levels, the government will have to cut more.

... and the Opposition Takes Aim

¶5. (SBU) Having gained some, but not enough, political advantage over the last several months from haranguing the government on the economy and impending budget, the opposition's reaction to the budget announcement focused on Lenihan's comments about this being the "last" difficult budget. According to press reports, Fine Gael finance spokesman Richard Bruton dismissed the idea that the worst was over and pointed out that an office cleaner in the Finance Department would take a larger proportionate pay cut than Lenihan. Labour Party leader Eamon Gilmore described the announcement as, "a scam designed to mislead the public." Even Green Party leader John Gormley, whose party is a

junior partner in the government, could only offer tepid support saying, "given the difficult choices we had to make, I believe it is, in the main, a fair budget."

¶6. (C) On December 10, PolOff spoke with Mark Garrett, Chief of Staff for the Labour Party who noted that "there is a disconnect between the media and the public. The media has taken a "pain is necessary" stance, but the public is disenfranchised. Ireland isn't France and there won't be rioting in the streets, but there is a strong likelihood that this will manifest itself in the political arena." Econoff spoke with Andrew McDowell, Director of Research for Fine Gael, who said that "there were no great, visionary ideas, despite what was signaled in the McCarthy report. Not one state agency was abolished." He added that the budget did not set out a, "new plan for the economy or public sector reform."

Unions Threaten Action

¶7. (C) The unions are less than pleased with the budget and are calling for strikes in response. Peter McLoone, head of the largest public sector union, Impact, warned the government that his 350,000 members would now prepare for industrial action. McLoone said that the government's intention to cut the link between public sector pay and pensions meant that the government had decided to "walk away" from the social partnership arrangement. (Note: the social partnership is the process of negotiation between employers, unions, and the government on employment-related issues. The process contributed to the revival of the Irish economy but many now question its relevancy. End Note.) Garrett suggested that the reaction would be much less severe. He noted that there is unlikely to be an additional walkout as the public sector is smarting from the salary reduction and most aren't eager to lose additional days of pay. Garrett added that union members will likely react by not cooperating with proposed reforms and creating other difficulties at the

local level.

Comment

¶8. (C) There was never really any mystery about what would be in the budget. The governmentdid a good job of signaling its intentions early on and allowing the public to come to grips with the reality over time. What is a mystery is why Lenihan would issue the statements on a rebound in the economy and the end of the tough budgets. It is hard to find someone who agrees with him and it is likely that next year's budget will be even more difficult. Whether it was bad speechwriting, a slip-up, an attempt to kick-the-can down the road, or something else, the opposition will surely reference these comments next year in the lead up to Budget 2011. That said, we expect the budget announcement to have little political impact on the government coalition and we do not expect the unions will force a walk-back on public sector pay cuts. The government has no other "less bad" option.
ROONEY